**Office of Chief Counsel**
**Internal Revenue Service**

# memorandum

CC:NER:CTR:HAR:TL-N-1907-99
REMarum

date:

to: Chief, Examination Division, Branch I
Connecticut-Rhode Island District

from: District Counsel, Connecticut-Rhode Island District, E. Hartford

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subject: **Treatment of TEFRA Issues on Audit**
**Re: Applicable Statute Expiration Periods**

**THIS DOCUMENT MAY INCLUDE CONFIDENTIAL INFORMATION SUBJECT TO THE ATTORNEY-CLIENT AND DELIBERATIVE PROCESS PRIVILEGES AND MAY ALSO HAVE BEEN PREPARED IN ANTICIPATION OF LITIGATION. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE OUTSIDE THE SERVICE, INCLUDING THE TAXPAYERS INVOLVED, AND ITS USE WITHIN THE SERVICE SHOULD BE LIMITED TO THOSE WITH A NEED TO REVIEW THE DOCUMENT IN RELATION TO THE SUBJECT MATTER OR CASE DISCUSSED HEREIN. THIS DOCUMENT ALSO IS TAX INFORMATION OF THE INSTANT TAXPAYERS, WHICH IS SUBJECT TO I.R.C. § 6103.**

Reference is made to your memorandum dated March 5, 1999, attaching a memorandum from the Case Manager, EG 1102 dated March 2, 1999. The March 2, 1999 memorandum was revised on May 4, 1999. The revised memorandum requested clarification for two memoranda, one from Meryl Silver, formerly of this office, dated August 6, 1996, to Carole Chapman, recommending the addition of certain language to the standard Form 872 for a corporate taxpayer to extend the period of limitations for all partnership items on its return. The second memorandum from Thomas W. Wilson, Jr., National Director, Corporate Examinations CP:EX:G to Regional Chief Compliance Officers concerned the treatment of TEFRA issues on audit regarding the applicable statute expiration periods and addressed the guidance sought by the Connecticut-Rhode Island District regarding a certain factual situation frequently occurring in the Coordinated Examination Program ("CEP"). Litigation Guideline Memorandum ("LGM") TL-81 (Rev), issued on September 25, 1998, expanded on various matters discussed in the Wilson memorandum. On July 21, 1999, this LGM and all other LGMs were released to the public in redacted versions.

The facts set forth below are summarized from the memorandum

dated March 2, 1999, as revised on May 5, 1999, and the accompanying materials:

1. In the August 6, 1996, Silver memorandum, she recommended, after coordinating with our National Office, that the following language be added to the standard Form 872 to extend the period of limitations for all partnership items on a corporate return:

> Without otherwise limiting the applicability of this agreement, this agreement also extends the period of limitations for assessing any tax (including additions to tax and interest) attributable to any partnership items (see I.R.C. § 6231(a)(3)), affected items (see I.R.C. § 6231(a)(5), computational adjustments (see I.R.C. § 6231(a)(6)), and partnership items converted to nonpartnership items (see I.R.C. § 6231(b). This agreement extends the period for filing a petition for adjustment under I.R.C. § 6228(b) but only if a timely request for administrative adjustment is filed under I.R.C. § 6227. For partnership items which have been converted to nonpartnership items, this agreement extends the period for filing a suit for refund or credit under I.R.C. § 6532, but only if a timely claim for refund is filed for such items. In accordance with paragraph 2 above, an assessment attributable to a partnership shall not terminate this agreement for other partnerships or for items not attributable to a partnership. Similarly, an assessment not attributable to a partnership shall not terminate this agreement for items attributable to a partnership [The issuance of a notice of deficiency will not terminate this agreement under paragraphs (1) and/or (2) for the items described by this paragraph.]

2. The Wilson memorandum responded to a contact from the Connecticut-Rhode Island District, requesting guidance as to whether I.R.C. § 6229 or I.R.C. § 6501 would apply to a certain factual situation, frequently occurring in the CPE program, as described below:

Large corporations that are partners in TEFRA partnerships may file corporate returns, showing estimates of distributive income/loss. During the examination the corporations may notify the examination team of inconsistencies between what was reported and the K-1s from the partnerships. Such adjustments may then be included in the RAR and assessed when the examination is completed. Usually, by the time the CEP examination has been completed, the taxpayer has executed an extension under I.R.C.

§ 6501 per a Form 872, but the TEFRA statute of limitations (I.R.C. § 6229) has expired.

The memorandum indicated that Chief Counsel's Office had confirmed that the K-1 amounts are partnership items that may be computationally assessed without resorting to a partnership proceeding under I.R.C. § 6222(c) in the absence of the taxpayer filing a notice of inconsistent treatment (Temp. Treas. Reg. § 301.6222(b)-1T). However, the issue has not been uniformly treated by the courts.

In view of the unsettled law, the memorandum recommended that districts either make "direct assessments" to correct the inconsistent treatment of the partnership item as reported on the corporate tax return as soon as the adjustments become known, or extend the I.R.C. § 6229 TEFRA statute of limitations. In the latter situation, the memorandum advised the Examination Team to consult with local District Counsel for the precise language to be inserted on Form 872 to extend the TEFRA statute.

The memorandum related that Counsel had advised that in certain circumstances it would be able to defend the position that section 6229 merely sets forth a minimum period during which the partner's period for assessment under section 6501 shall not expire for partnership items. Under that interpretation, the Service would be able to assess partnership items as long as the partner's period for assessment under section 6501 remained open. In situations arising in which the section 6229 period had expired but the partner's period for assessment under section 6501 remained open, it advised Examination personnel to consult with District Counsel attorneys, who would then seek National Office, Chief Counsel coordination.

3. On September 25, 1998 LGM TL-81 (Rev) was issued, superseding LGM TL-81 (Rev March 7, 1991), updating the discussion of appropriate statute of limitations governing TEFRA proceedings to take into account recent developments in the case law. It focused on the statute of limitations for the partners under section 6501 and the extent to which it is affected by the TEFRA audit and litigation procedures. The memorandum expanded upon some of the matters mentioned in the Wilson memorandum, discussed above. LGM TL-81 (Rev) addresses some of the questions and concerns posed in your memorandum dated March 5, 1999 (revised May 5, 1999). As mentioned above, LGM TL-81 (Rev) was released to the public in a redacted version on July 21, 1999. **We caution that there is no guarantee the courts would adopt the logic of Chief Counsel, as set forth in LGM TL-81 (Rev). To avoid uncertainty, including the possibility of expired statutes, the additional language, quoted above, should be used on all**

**initial extensions and subsequent renewals.**

When you are soliciting statute extensions, it is your interpretation that the following should be done:

1. For all corporate extensions for calendar year 1995 you will add the additional language described in the 8/6/96 memorandum;

2. For years that have signed statute extensions, you will not include the additional language, since it was not originally considered;

3. If you know the corporate taxpayer incorrectly reported its distributive share of a TEFRA entity's income/loss, you will solicit an extension (Form 872P) of the TEFRA statute and not add the language to the corporate statute extension.

4. You will not solicit TEFRA statute extensions without specific documentation that the corporation erroneously reported its share of the TEFRA income/loss. In some instances this would mean that you have reconciled partnership income/loss and in others you have yet to examine the line item.

In following those procedures, you have the following concerns [set forth in bold] about matters that may arise that are case specific:

**1. Are we precluded from including the additional language on statute extensions when the previously executed extensions did not include the language?**

Yes. The additional language should be used for all initial extensions and renewals thereafter.

**2. Should a taxpayer refuse to sign a corporate statute extension with the additional language and/or refuse to sign a partnership (TEFRA) statute extension, would we be precluded from adjusting a corporation's distributive share of TEFRA entity's income/loss? Please note that in this situation, the Taxpayer would have signed a corporate extension (F872) but it did not include the additional language.**

Yes. If this situation arises, you should consult with District Counsel. Any case advancing the argument that a notice was timely under section 6501, despite the fact that it was not issued within the section 6229 minimum assessment period, would first have to be coordinated with the National Office, Procedural Branch of the Field Service Division. See LGM TL-81 (Rev), pp.

14 and 16. Each case would have to be considered on its facts and circumstances.

**3. Without the additional language in the corporate statute extension and/or without a partnership (TEFRA) statute extension, would we be precluded from making an adjustment in the taxpayer's favor? This assumes that the corporation overestimated its distributive share of partnership income or underestimated its share of partnership loss.**

Yes. The additional language offers protection to the corporate taxpayer regarding TEFRA adjustments in its favor and should be used for all initial extensions and subsequent renewals. While Chief Counsel's view is that section 6229 only sets forth a minimum assessment period, serving to extend the section 6501 limitation on assessment, there is currently no court cases in which the interplay between sections 6501 and 6229 has been addressed in a dispositive manner. See pp. 10 and 13 of LGM TL-81 (Rev). The additional language provides protection to both the government's and the taxpayers's interests.

**4. We can make a corporate assessment for the changes to partnership (TEFRA) income/loss within the normal three-year statutory period for the corporation. What would we do if we had to process a corporate overassessment or if we were only revising the corporate NOL?**

The additional language offers protection to the taxpayer when the TEFRA assessment results in a refund but the audit is incomplete, and it should be used. Absent the special language, the taxpayer could argue that a section 6501 extension is sufficient to keep the TEFRA statute open, basically arguing the LGM TL-81 (Rev) position. However, there is no certainty the courts would adopt this approach. We recommend that taxpayers be advised how and why the additional language protects them in the situation described.

**5. If we have an executed corporate extension with the additional language, is it necessary to secure an 872P for the TEFRA entity if we do not plan on examining the entity but merely correct the corporate reporting of the distributive share of income/loss?**

No. There is no need for the TMP to execute an extension for the partnership statute for all partners when you have an executed extension of the section 6501 statute, coupled with the additional language, for the corporation you are examining.

**6. If a corporate taxpayer makes a disclosure at the start of the examination to avoid I.R.C. § 6662 penalties and the disclosure corrects its reporting of a partnership income/loss item, would this change continue to be a TEFRA item requiring the partnership statute to be open?**

A correction of the K-1 amount would be a partnership item, which may be computationally assessed without resorting to a partnership proceeding, pursuant to I.R.C. § 6222(c) in the absence of the taxpayer filing a notice of inconsistent treatment (Temp. Treas. Reg. § 301.6222(b)-1T). See the Wilson memorandum. Absent a computational assessment, the change would continue to be a TEFRA item, requiring the partnership statute to be open. The additional language would, of course, be required.

**7. We have an executed corporate extension (without the language) but before the normal three-year statutory period has expired. Can securing another corporate extension with the language supersede this extension? This assumes that the revised corporate extension is secured within the normal three-year statutory period.**

Yes.

**8. Shouldn't we be consistent in our approach? By this I mean we rely upon the corporate waiver (with or without the language) or rely upon TEFRA extensions, rather than the hybrid method as outlined in the memos.**

To best protect the government's interests, you should add the suggested language to the standard Form 872 to extend the statute of limitations for all partnership items on a corporate return. If you secure a corporate waiver without the language, and the notice is not issued within the section 6229 assessment period, you should consult with District Counsel. We would then coordinate with the National Office Procedural Branch of the Field Service Division, which may or may not approve the issuance of a notice. See LGM TL-81 (Rev), including pp. 14 and 16.

**9. Once we solicit extensions with the additional language, aren't we alerting taxpayers to appeal an assessment made without the language.**

Yes; however, using the additional language best protects the government's and the taxpayer's interests.

The taxpayers now have access to a redacted version of LGM TL-81 (Rev) and may already be aware of the Service's position with respect to the TEFRA statute of limitations, specifically I.R.C § 6501 and the extent to which it is affected by the TEFRA I.R.C. § 6229 provisions. It is possible that some taxpayers have become more aware of the Service's concerns about how a court may address the dispositive issue of the interplay between sections 6501 and 6229 through questioning the reasons for the insertions of the additional language or through reviewing LGM TL-81 (Rev).

Your revised memorandum included nine different situations concerning the treatment of TEFRA issues, not set forth in your original memorandum [set forth in bold].

**Situation # 1: P (Partnership) is not under examination. P statute has expired (or will expire by the time the corporate RAR is to be executed by the taxpayer). C (Corporation) statute is extended by Form 872 (without additional language). The examiner requests K-1s to verify amount of partnership income/loss reported by C. If the income was reported incorrectly, can we make the change within the corporate RAR?**

The partnership K-1 amounts are partnership items that may be computationally assessed without resorting to a partnership proceeding pursuant to I.R.C. § 6222(c) in the absence of the taxpayer filing a notice of inconsistent treatment. (Temp. Treas. Reg. § 301.7222(b)-1T. In the event that is not done and you want to rely on I.R.C. § 6501 to argue that a notice is timely under that section, despite the fact that the notice was not issued within the 6229 minimum assessment period, you should refer the matter to District Counsel. We would have to then coordinate with the National Office Procedural Branch of the Field Service Division. See LGM TL-81 (Rev), pp. 14 and 16.

**Situation # 2: Same facts as # 1 except C statute extension includes the additional language. Can we make the adjustment identified in # 1.**

The Service, relying upon the statute extension containing the additional 6229 language, may make the adjustment.

**Situation # 3: P was examined, an RAR has been executed and we have been informed of corrections to C's share of income/loss. Under TEFRA we would have one year to make the TEFRA assessment to C; however, the examination of C will not conclude by then. Must (should) we write an interim (or partial) report if we have a corporate extension (without the additional language).**

Yes.

**Situation # 4: Same as # 3 except C has a statute extension (with the additional language). Can we wait until the end of the corporate audit and make all changes (TEFRA and Non-TEFRA) within an RAR that will be prepared and executed beyond the one-year TEFRA assessment date? Or, must we still adhere to the one-year TEFRA assessment date?**

Yes as to the first question. If you have a statute extension with the additional language, you may wait till the end of the corporate audit and make all TEFRA and non-TEFRA changes within the RAR that will be prepared and executed beyond the one-year assessment date. The additional language makes specific reference to "partnership items converted to nonpartnership items"

**Situation # 5: If a TEFRA change would reduce a corporate taxpayer's liability, under any circumstances would we be precluded from making a change in C's favor?**

The additional language includes the following sentence: "This agreement extends the period for filing a petition for adjustment under I.R.C. § 6228(b) **but only if a timely request for administrative adjustment is filed under I.R.C. § 6227."** (emphasis added) Pursuant to section 6227(a), a partner may file a request for administrative adjustment of partnership items for any partnership

(1) within 3 years after the later of--

(A) the date on which the partnership return for such year is filed, or

(B) the last day for filing the partnership return for such year (determined without regard to extensions), and

(2) before the mailing to the tax matters partner of a notice of final partnership administrative adjustment with respect to such taxable year.

If the taxpayer failed to comply with section 6227, you would be precluded from making the change in the taxpayer's favor. See the additional language quoted above.

**Situation # 6: What is the correct verbiage to use when including language on a corporate statute extension.**

Recently, on September 9, 1999, Thomas W. Wilson, Jr., Assistant Commissioner (Examination), issued a memorandum concerning Corporate Consents and Coordinated Examination Program (CEP) Cases, recommending that large case examiners use the attached approved language when extending the statute on a Form 1120. This language, which we have bolded below supersedes the language set forth in the Silver memorandum, quoted above:

**With regard to interests held in entities that are subject to the TEFRA unified audit and litigation procedures, and without otherwise limiting the applicability of this agreement, this agreement also extends the period of limitations for assessing any tax (including additions to tax and interest) attributable to any partnership items, affected items, computational adjustments, and partnership items converted to nonpartnership items. This agreement extends the period for filing a request for administrative adjustment and the period for filing a petition regarding such a request. For partnership items that have been converted to nonpartnership items, this agreement extends the period for filing a suit for refund or credit. In accordance with paragraph (1) above, an assessment attributable to a partnership shall not terminate this agreement for all other partnerships or for items not attributable to a partnership. Similarly, an assessment not attributable to a partnership shall not terminate this agreement for items attributable to a partnership.**

If a Form 872A is used, you must add the following:

**The issuance of a notice of deficiency will not terminate this agreement under paragraphs (1) and/or (2) for the items described by this paragraph.**

**Situation # 7: Are we being advised to start every corporate examination by securing TEFRA extensions on all partnerships as a protective measure. This could be a substantial undertaking, a major commitment of time and would likely meet significant opposition from corporate taxpayers.**

Yes. See the Wilson memorandum of September 9, 1999.

**Situation # 8: The C statute expires 9/15/99. The P statute expires 6/15/99. Should we only secure a C statute extension (with/without the additional language), must we secure the C extension before the P statute expires? This assumes that we find that C has made an error in reporting its distributable share of P's income/loss.**

If you plan to secure a C statute extension, you should get it as early as possible, especially before 6/15/99. Otherwise, possible problems could result. While p. 5 of LGM TL-81 (Rev) states as follows in a similar scenario: "[S]ince the section 6501 assessment period for the corporation will remain open without regard to section 6229, assessments attributable to the partnership items may be made at any time before September 15, 1999," no court has yet ruled on this matter in a dispositive fashion. To avoid uncertainty, the C statute extension with the additional language should be secured before June 15, 1999.

**Situation # 9: Similar to above, assume that a C statute extension (with language) is secured after 6/15 but before 9/15. Would we be precluded from correcting C's reporting of its partnership income/loss?**

See comments for Situation # 8.

Please note that this opinion is based upon the facts set forth herein. Should you determine that the facts are different, you should not rely upon this opinion without conferring with this office, as our opinion might change. Further, this opinion is subject to post-review in our National Office. That review might result in modifications to the conclusions herein. Should our National Office suggest any material change in the advice, we will inform you as soon as we hear from that office.

The subject case is assigned to Robert E. Marum of this office, who may be reached at (860) 290-4068 should you have any further questions.

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By: _____
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